EXISTING CONSTITUTIONAL LIMITATIONS ON SOUND STATE FISCAL POLICY

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THE future fiscal policy of New York state will be an immediate concern of the coming constitutional convention. It is easy to advocate political or economic reform and to urge alterations in the administrative structure of the state government and its local agencies; but while sound and necessary reforms should not be estopped on the pretext of impending expense, they should not in turn be made the basis of maximum expenditures with minimum results. To the extent that the existing constitution will permit of administrative changes on a sound financial basis, it should be retained and strengthened in those particular provisions; and in so far as the present instrument is a "limitation on sound state fiscal policy," it should be broadened with a vision of the increasing functions of government, especially as to the management of municipal enterprises, during the generation in which the new compact is to be operative. Thus, in respect to its fiscal features, the new constitution must so check proposed state and local expenditures that deliberation will precede investments in capital accounts or for operative expenses; but it must likewise provide a method whereby the people of the state or its subdivisions may be aided, not retarded, in carrying out projects of accepted merit, once the merit has been determined.

The primary duty of the makers of the new constitution is to safeguard existing investments in public securities. There must be no impairment of present obligations in the name of progress. The letter of the bonds must be respected. This is the essence of sound law and good morals; but indeed it is more. When these state and municipal projects and enterprises are contemplated, which must receive the sanction of the

new constitution if that instrument is to be something other than the foe of true progress, it becomes evident that the sovereign and its local agencies will need increasing markets for public obligations during the generation ahead. Any proposed feature, then, of the coming constitution which seeks to alter the letter of these obligations, defeats the larger future purposes of the state. Strong as is the state, its creditors are given no fundamental protection such as is afforded to private creditors under the federal provision preventing the impairment of the obligation of contracts by state legislative action. Where the law of the obligation is weak, the moral sense must be keener. It follows from these premises that any sinking-fund or retirement provisions relating to bonds outstanding must be re-inserted in the new constitution as to those issues, even though the same clauses seem to be a limitation on the future fiscal policy of the state. It will require, indeed, the best thought of the convention to preserve the sanctity of present obligations, while devising a fiscal system for the benefit of a state and cities destined to enter upon larger undertakings during the present century. A consideration of some features of this task is the purpose of this paper.

The financial policy of this state may be found in section four of article seven and section ten of article eight of the constitution. To be sure, there are certain other sections as to canal and highway bonds, as well as provisions as to uniformity of taxation, but the essentials of the state's policy from a constitutional standpoint were incorporated in the clauses mentioned. These sections must be read together because, while one defines just what are permissible expenditures for the state government and its subdivisions, the other determines how these funds shall be secured and repaid. A change in one means an alteration in the other, or perhaps additions thereto. For the purposes of this discussion let us bear in mind these essential provisions of section four: (a) no debt shall be contracted unless authorized by law, (b) unless the bill authorizing the debt or expenditure provides for the levying of an annual tax sufficient to pay the interest and discharge the principal obligation within fifty years, and (c) with certain excep-

tions recited in preceding sections, unless the people have authorized the indebtedness. These clauses are followed by section five, providing for the separate investment of tax moneys raised for sinking-fund purposes and declaring the same to be inviolate.

Notice the relationship of the more important parts of section ten of article eight to the preceding provisions. It prohibits counties, cities and villages from loaning their credit to, investing in the stock of, or purchasing the bonds of corporations; nor can those local subdivisions incur any indebtedness except for county, city or village purposes; this is coupled with the proviso limiting such indebtedness to ten per centum of the assessed valuation of the real estate of the particular subdivision, except that water bonds of twenty years duration may be issued, even though the current obligations exceed ten per centum, or even though by such issuance the total indebtedness is brought above the constitutional limitation. This is followed by certain clauses whereby in given instances obligations of Greater New York, issued for specific projects, may be withdrawn or eliminated in the calculation of the debt limit.

The constitutional convention will be fulfilling its duty to the holders of present public securities, as well as providing a sound basis for the future, if it re-adopts these cited sections, in the main. This conclusion is true because the obligations have been issued under these sections; the courts have interpreted them in liberal fashion; and they have met the test of experience, especially from the standpoint of state, rather than local, fiscal policy. But there must be additions to these sections and some changes in detail, especially from the viewpoint of the cities, in order to provide a fiscal system which will promote municipal progress on a sound basis.

The specific change in public sentiment, since the present constitution was adopted in 1894, is not difficult to determine. In relation to the political subdivisions of the state, in distinction from the sovereign itself, the constitution limits expenditures to "city purposes" and then provides the method of borrowing and repaying the sums expended by these localities.

It has been the problem of the courts to determine just what were warrantable expenditures for local purposes. The courts of this state in meeting this problem have kept just far enough in the rear of public sentiment to impel deliberation, before expenditure, upon the part of municipalities. It is certain that during the last decade of this constitution, and with certain exceptions of a wholly local nature, the courts have broadened the meaning of "city purposes" as rapidly as the people and officials of the political subdivisions have shown their ability to administer enterprises made permissible thereunder.

But it is a notable fact in these days of municipal lighting plants and city-constructed subways, that the only "city purpose" mentioned on a state-wide scale in the original draft of this section in 1894 is the clause relating to the issuance of bonds for municipal water plants. It is true that even before 1894 certain cities had engaged in trading or business enterprises other than the conduct of water plants. But those departures were regarded with suspicion, and even the ownership of water systems was still apologetically excused by some on the ground of public health. But in the interval the man who opposes the public ownership of certain accepted public utilities has been placed on the defensive. The ownership of certain public services on a widening scale is a part of every municipal program. The need for broadening certain fiscal features of the constitution arose the day that the court of appeals decreed that Dunkirk had a right under the "city-purposes" clause to sell commercial lighting as an incidental part of the operation of a municipal lighting plant. This initial decision of the court, coupled with succeeding opinions involving some phase of similar city conditions, furnished the groundwork of that brief whereby Edward M. Shepard induced the court to sanction the construction of rapid-transit systems by the city of New York.

The framers of the new constitution, then, will be confronted by the arguments of two classes of municipal-ownership advocates. One class will urge that the constitution should sanction all that the courts have done; that the privilege of engaging in certain enterprises should be authorized specifically,

lest some turn in the tide of public sentiment prompt the courts to reverse their liberal and broadening interpretations of the "city-purposes" clause of the constitution; and they will want to add to this list, as first approved by the courts, and then sanctioned by the new constitution, certain other municipal activities. The writer has no quarrel with the intentions of these advocates. He favors an extension of municipal ownership, but he knows that its permanent extension must be on a basis of financial solvency authorized by the constitution. Thus he hopes that in the interests of genuine municipal fiscal progress, the convention will give heed to the other school of city thinkers, who urge and hope that the constitution will not bind the courts and the people by a specific enumeration of city purposes or projects, but that it will leave to the judiciary and to the people of given localities by some definite method to determine just what additional municipal ventures are permissible under the constitution as applied to the prevalent local conditions. Put this latter proposal to the test of practicability. What would be the measure of municipal progress to-day had the last constitution enumerated, in the then adverse state of public sentiment, just what municipal enterprises constituted "city purposes?" Has not more real progress been made, and on a sound, deliberate basis, by the courts countenancing from year to year, first one and then another municipal enterprise as within the "city-purposes" clause? And will not the true interests of municipal progress be served if the convention establishes a broadened fiscal system as a means of enabling cities to finance such enterprises as may be approved by the courts and the local taxpayers? There is no paradox in opposing the specific enumeration of city purposes and projects and then urging the incorporation of a particular fiscal system in the constitution, because it is a matter of business experience that bonds for either a smaller or a larger measure of municipal enterprise cannot be marketed unless the method of their issuance is general in scope and possessed of express constitutional sanction.

There will be an insistent demand for home rule for cities, in the coming convention. "Home rule" is an indefinite

term, and it can be made to suit the purposes of any visionary; but it is assumed for the purposes of this discussion that some measure of home rule will be granted by the constitution makers. But the financial aspects of home rule will be the most troublesome feature. It is certain that the convention cannot meet the expectations of home-rule advocates in that respect. The demand for home rule centers in the commission-government needs of cities. The latter is a movement of business men for business-like local government, and it should not be deprived of that merit by the convention's granting an unwise measure of home rule, especially as to the financial policies of municipalities.

The writer favors home rule, and he is convinced that this generation will witness a larger degree of public ownership by cities. But those who are for, and those who are against, an extension of municipal ownership should unite in insisting that the constitution place it on a basis of assured solvency. Those home-rule advocates who think that the existing debt limitation for cities should be abolished, and that the nature and extent of city indebtedness should depend upon the wisdom or prejudices, or both, of local taxpayers, no less than those municipal ownership advocates who think that the "city-purposes" clause should be broadened so as to include by specific enumeration a large number of additional municipal enterprises, or those who want the taxpayers of a city privileged to determine by a referendum what are "city purposes" and how the acquirement and operation of plants thereunder shall be financed, not only are defeating their own ends, but are proving themselves to be foes of municipal progress.

The home-rule advocates must remember that cities are governmental agents and not sovereigns; that those agents are without inherent rights, but enjoy privileges in the discretion of the state, and by concession of the whole people when power is delegated to local subdivisions by the ratification of a constitution. These home-rule advocates may point to the fact that the cities of England issue obligations for a large variety of municipal projects and without the protecting or restraining hand of a written constitution; but they fail to recall that each

bond issue requires the authorization of Parliament, except where it is for those ordinary purposes which may be approved by the local administration board. Certainly the cities of New York have enjoyed a larger and safer measure of local control under the constitution than if the legislature had been empowered to determine what enterprises they should acquire and how they should finance their acquirement. Either the English legislative or the American constitutional method must be followed in determining the fiscal policies of our cities; and the former is justified only where the legislative body, like Parliament, is the supreme arbiter of the state and the interpreter of its constitution.

Obligations of the cities of New York are now outstanding under constitutional sanction. The same instrument declares invalid any bonds issued outside its purview. These obligations have been taken by city creditors in good faith, and because of the constitutional assurance that the present and future issues would be limited. The increase in the assessed valuation of local real estate is made the measure of bond-issuing possibilities. This is the truest standard of municipal finance. To sweep away this standard, even under the guise of home rule, is a fraud. There is nothing sacred about a ten per cent limitation, but some definite limit of municipal indebtedness, in relation to assessed valuation, should be considered sacred. Under and because of this existing limitation, municipal securities have been legalized as investments for savings banks in several of the states and for the trustees of estates. It is certain that the withdrawal of this limitation and the vesting in cities of the power to determine the purpose and extent of local indebtedness, will be followed by the repeal of the acts authorizing these investments. But that will not be the final effect. The municipal-ownership advocates as a class favor home rule; but it will not be possible to market the city securities needed in any extension of city ownership unless there are constitutional clauses limiting the possible indebtedness. If successive bond issues await only the favorable action of a locality, funds will not be available for public ownership on the scale contemplated by some. Those who

want a broadening of the meaning of "city purposes" should be the very ones to insist that these projects be placed on a business basis.

Nor should the sinking-fund provisions of the coming constitution be ignored. No bond should be issued without automatic provision for its retirement. The provision of the constitution limiting the years for which the state or cities may issue obligations should remain. A yearly tax should be levied to meet a part of the principal of each bond issue. The accumulation of large sums out of current tax levies, to constitute a sinking fund with which to retire a bond issue, in the distant future, is a fruitful cause of public corruption. It seems that the states and cities should reserve the right to retire a proportionate part of a bond issue each year.

And there are some reasons why the latter should be a positive requirement in connection with the obligations issued by cities for the purchase of business enterprises. In fact, in redrafting the fiscal features of the new constitution, it will be well for the convention to keep in mind the distinction between bonds issued for city halls, sewers and pavements, which do not yield a revenue, and for which service no charge may be made, and obligations authorized for the purchase of water and lighting plants, or the like, which yield a return and for whose service to private citizens charges may be made. City demagogues have thriven by eliminating sinking-fund and depreciation charges from the calculations of municipal-ownership expenses, and then convincing the people that this type of vicious and indirect subsidy is in their interest. The placing of city-owned systems under the jurisdiction of the public service commission has tended to stop this practice. If bonds issued for the purchase of property, in contradistinction to obligations issued in connection with the exercise of a local governmental function, were retired proportionately each year it would be necessary to calculate the sinking-fund charge with precision, and the protests of the taxpayers would prevent those moneys from coming out of the annual levy, rather than out of the revenues of the particular property. Moreover, by careful investigations and adjudications the average life

of a particular type of municipal system may be determined, and no bond issue should be permitted for a period longer than the life of the plant.

All these things cannot be inserted in a constitution. The constitution must be considered as the embodiment of necessary fiscal principles. These items are mentioned to emphasize the conviction that the next constitution must delegate large discretionary powers to the legislature in relation to state fiscal policies and city government.

And if the state is to hold the cities to a high standard of fiscal policy; if the cities are to be granted home rule, but subject to debt limitations under the constitution; if the localities are to be allowed to join with the courts in giving a broader meaning to permissible "city purposes" from year to year, as regards municipal-ownership activities, then should there not be some automatic method which will to a partial extent grant to those cities which conduct their systems efficiently a larger measure of home rule, than to those which burden the taxpayer by poor service or by requiring tax levies to maintain their plants? This method can be found; but it cannot be applied unless the constitution draws the distinction, as previously suggested, between obligations issued for governmental purposes and those required for the purchase of quasi-business systems. The same rule should not apply to a bond issue for a city hall and a revenue-producing water plant. One must be paid for by the taxpayer and the other should be paid for by the consumer. In fixing city debt limits, the new constitution should separate the two and make provision accordingly. As to bonds for city-hall purposes and the like, the clause should be definite and inelastic; but as to obligations for water, light and similar municipal plants, the provision should be elastic and discretionary. As a matter of public credit, all bonds issued, in the first instance, and without respect to the principle underlying the suggested separation, should be a municipal lien and be counted against the debt limit. But it is urged that the constitution should empower the legislature to permit a city which conducts a particular enterprise with success and which provides for the sinking-fund and depre-

ciation charges without resort to taxation, for a given period of years, to establish those facts before a commission, or in an appellate court proceeding and then to withdraw that bond issue from the calculation of the permissible city debt limit. This enables a city to acquire other enterprises when it has demonstrated its capacity to conduct existing systems.

In the investigation of the financial features of several state and city enterprises in the United Kingdom the writer found that in many instances the public service systems were purchased, subject to existing trust mortgages and bonds. This simplified the acquirement of these properties, and the method has been successful; but it does not follow that it should be adopted in this state, even though it is now being tried in the cities of western Canada. The plan may be permitted, or not, in England or the Dominion, because an enabling act must be obtained from Parliament or the provincial legislature. This requirement permits the legislators to pass upon the desirability of taking over a public service system, subject to existing mortgages, instead of issuing city bonds for the whole purchase price, upon the merits of each proposition; but where, as in New York, it is necessary to devise a uniform method of municipal financing, and insert it in a constitution, this plan is not feasible. The advantages of the plan may be gained here by withdrawing from the calculation of the debt limit those bonds issued for plants paying a revenue for successive years.

No new constitution may be deemed a liberal instrument, which does not enable the state and its subdivisions to absorb those values accruing through the exercise of governmental functions, and community effort. The "excess-condemnation" amendment was a step in that direction. A constitution which embodies a sound state fiscal policy must provide not only for efficient and inexpensive administration; but it must assure to the people the profits accruing from an extending ownership of systems inherently quasi-public in their nature and service, coupled with payment into the treasury of those franchise and site values which are enhanced by the efficiency of the government and by its increasing ownership of public utilities.